WRITTEN STATEMENT OF

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U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

HEARING ON

HUD Report "CDBG Formula Targeting to Community Development Need"

BEFORE THE

U.S. HOUSE OF REPRESENTATIVES

COMMITTEE ON GOVERNMENT REFORM

SUBCOMMITTEE ON FEDERALISM AND THE CENSUS

On behalf of the President and Secretary Jackson, I would like to thank the subcommittee and Chairman Turner for the opportunity to speak with you today about a recently released HUD report on the CDBG formula and how it performs relative to community development need.

This is the fifth time HUD has prepared a report like this since 1974 on how the CDBG formula targets to need. Like our previous reports we've generally asked the question…how is the CDBG program doing in terms of meeting the community development need in this country?

The first report provided the framework for creation of the dual formula that first allocated funds in 1978. The current formula is comprised of a Formula A and a Formula B. HUD calculates the amount for each grantee under both formulas. Grantees are then assigned the larger of the two formula amounts. Generally, communities with poverty and overcrowding get higher grants under Formula A, while communities with distressed housing and slow population growth get higher grants under Formula B.

In 1983 and 1995 we found that CDBG's formula had become increasingly LESS effective in targeting need. The problem is that while the variables in the formula have not changed since 1978, this country has. I am sure that it comes as no surprise to any of you, the United States is a significantly different country than it was nearly 30 years ago. We are seeing significant demographic and economic change…some communities have experienced tremendous growth while others are in decline.

Not surprisingly, when HUD began to examine the numbers from the latest Census, we noticed that the CDBG formula continues to be a less effective vehicle for targeting need. Today, I would like to outline our findings and offer some options should you consider changing the program's formula to meet today's needs.

As with prior studies, we designed an index to try to rank each community based on its relative level of community development need. This needs index uses variables that directly relate to the statutory objectives of the CDBG program such as poverty, crime, unemployment, and population loss. A total of 17 variables were identified for entitlement communities…those are cities and larger urban counties that receive direct funding. For the states or "non-entitlement" program, we created a needs index using 10 variables.

Applying techniques used in the previous four studies, those variables are combined into a single score for each community.

When we compare how the current formula is allocated against this needs index, we see some stark examples of funding disparity. For example, communities with similar need may receive significantly more…or less funding on a per capita basis. We also find examples of communities with less need receiving roughly the same amount of funding as higher need areas.

Exhibit 1 illustrates this point. I apologize for the complexity but I think this will become clear shortly.

This chart shows how CDBG's current formula is targeting need today. You will see along the bottom of this chart, communities are ranked by their relative level community development need, starting with the lowest need communities on the left and ending with the highest need communities on the right. The solid line represents an appropriate funding level relative to need for the per capita grant amount of the grantee community. The jagged line represents the per capita allocation for grantees under the current formula.

This chart demonstrates that CDBG's current formula is far from perfect. For example, some low-need communities such as Newton, Massachusetts; Portsmouth, New Hampshire; and, Royal Oak, Michigan are allocated more than 25 dollars per person while other low-need communities are receiving five-to-seven dollars per capita.

The starkest contrast, however, is among high-need communities on the right side of the chart. I will use three communities as an example. The cities of Saint Louis, Miami, and Detroit have similar needs according to our needs index, but get very different grant amounts. Saint Louis gets $73 per capita, well above the needs index line; Detroit gets $50 per capita; and, Miami gets $26 per capita, well <u>below</u> the needs index.

Why is this? There are several reasons, but two big reasons are in respect to the pre-1940 housing variable and growth lag variable in formula B. As distressed communities have demolished their older housing and the less distressed communities renovated their older housing, the pre-1940 housing shifted money from distressed communities to less distressed communities. In terms of growth lag, the relatively few communities that get funding under this variable get a lot of funding, since it is pegged to a communities population in 1960. It is the communities with growth lag that represent the "spikes" you see in the charts.

There are other elements to CDBG's current formula that tend to benefit smaller college towns with a high population of students earning little or no income. When you consider these students in measuring poverty you get a relatively higher grant as compared with similar communities with no significant student population but with absolutely higher poverty. Finally, the dual formula structure tends to provide greater funding to communities funded under formula B (developed for declining areas) than equally needy formula A grantees (developed for growing areas).

Let me also take a moment to talk about the non-entitlement formula that allocates 30 percent of CDBG funds to the States. The non-entitlement formula does not have the wild swings in funding as the formula our cities and counties use. As a result, there are no stark differences in funding between states, no matter their need. With the exception of Puerto Rico, the formula for the 50 States does not really target need at all.

The report considers four alternatives that all improve targeting to need. Here is a brief summary of each:

Alternative 1 keeps the current dual formula but corrects some of the more serious problems. For example, it defines the age of the housing stock a little more precisely. Instead of counting the number of units built before 1940, this option would measure "housing older than 50 years"

and occupied by a person in poverty. By establishing a means test on this housing variable, Alternative 1 generally redistributes funds from less needy communities to communities in decline.

Exhibit 2 shows the impact of these corrections. While Alternative 1 substantially reduces the over funding of low-need communities like Newton, Portsmouth, and Royal Oak, it only modestly reduces the funding difference between Miami and Saint Louis. Similar changes to the nonentitlement formula also have positive effects on targeting.

Alternative 2 is a very simple approach designed to minimize differences in funding among places with similar need. It is a single formula that uses four measures of need – poverty, female-headed households with children, housing 50 years and older and occupied by a poverty household, and overcrowding. As Exhibit 3 shows, this alternative greatly improves the fairness of the formula by reducing the per capita grant variation. The disadvantage of alternative 2 is that high need communities tend to fall below our needs line. Miami, St. Louis, and Detroit all get the same amount, however, they would fall below the needs index line.

Alternative 3 adjusts Alternative 2 to increase funding for communities in decline and exhibiting fiscal distress. As shown on Exhibit 4, this does improve targeting to the most needy compared to alternative 2. For example, under Alternative 3, Detroit and Saint Louis would receive grants of about $50 per capita and Miami would receive a grant of about $44 per capita. Alternative 3 has somewhat greater variation between similarly needy grantees relative to Alternative 2. However, Alternative 3 achieves greater targeting to the most needy communities.

Alternative 4 resembles Alternative 3 but eliminates the 70/30 funding split between entitlement and nonentitlement communities. That is, funding for nonentitlement areas and entitlement areas would be allocated under a single formula. This approach would currently result in a split of 69/31 of funding between entitlements and nonentitlements, very similar to the current split of 70/30. A chart for Alternative 4 would show the same distribution as the chart for Alternative 3, Exhibit 4.

In conclusion, today's formula -- again, a formula that hasn't been modified since 1978 -- places great emphasis on certain variables that may not be a true reflection of today's need.

I want to thank you for your time. If you have any questions I would be happy to answer them.